

In the United States Bankruptcy Court

for the Northern District of Iowa

ROY ALLEN NICHOLS and
TRACY ANN NICHOLS

Bankruptcy No. 87-01748S

Debtors.

MEMORANDUM OF DECISION AND ORDER RE: DEBTORS' MOTION TO AVOID LIEN

The matter before the Court is Debtors Roy Allen Nichols and Tracy Ann Nichols' Motion to Avoid Security Interest and Lien in Exempt Property and ITT Financial Services' (ITT) resistance thereto. A hearing was held December 11, 1987 in Sioux City, Iowa. The matter was submitted to the undersigned for consideration. The Court now issues this Ruling which shall constitute Findings and Conclusions as required by Bankr. R. 7052. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B).

I.

From the pleadings and the jointly offered exhibits, the Court finds the following facts:

1. On March 7, 1986, Debtor Roy Nichols executed a "90-Day Same as Cash Contract Iowa (Secured)" for the purchase of a waterbed and accessories from the Waterbed Room store of Sioux City, Iowa (Seller).
2. The contract stated that Seller intended to assign the contract to Thorp Credit, Inc. or one of its affiliates.
3. Seller assigned the contract on March 7, 1986 to Thorp Credit which does business as ITT, the resistor in this matter.
4. The contract provided for payment of the unpaid balance by Debtor on June 5, 1986, and granted ITT a security interest in the waterbed.
5. The unpaid balance on March 7, 1986 was \$674.79.
6. On June 5, 1986, Debtor executed a Note to ITT for \$1,260.75.
7. The Note provided for: an amount financed of \$764.13; a finance charge of \$496.62; a 36% annual rate of interest; and a 36-month payment schedule.
8. On June 5, 1986, Debtor executed a Security Agreement to ITT which subjected the waterbed referred to in the March 3, 1986 contract to a "purchase money security interest."

9. On June 5, 1986, Debtor acknowledged by his signature receipt of a completed copy of a Federal Disclosure Statement which explained terms used in the Note and Security Agreement and which set forth late payment and prepayment provisions.
10. Debtors (Roy and Tracy Nichols) filed a non-business Chapter 7 petition in bankruptcy on August 13, 1987 and listed ITT as a secured creditor for \$876.56.
11. Debtors claim the waterbed has a market value of \$150.00.
12. Debtors claim an exemption in household goods valued at \$905.00.
13. Debtors filed a motion to Avoid Security Interest and Lien in Exempt Property, concerning the waterbed and accessories, on August 20, 1987.
14. ITT filed a Resistance to Motion to Avoid Security Interest on August 28, 1987.

II.

Debtors argue that ITT has a nonpossessory, non-purchase money security interest in the waterbed which they claim as exempt property under 11 U.S.C. section 522 and Iowa Code ch. 627.

ITT's resistance apparently does not challenge Debtor's claim that the waterbed qualifies as exempt property under Iowa Code section 627.6(5). Rather, ITT argues that it has a purchase money security interest.

Under Iowa Code section 627.6, a debtor may exempt from execution

[t]he debtor's interest, not to exceed two hundred dollars in value in any particular item, in household furnishings, household goods, and appliances held primarily for the personal, family, or household use of the debtor or a dependent of the debtor, not to exceed in value two thousand dollars in the aggregate.

Iowa Code section 627.6(5).

A lien on exempt property may be avoided if the lien is nonpossessory, nonpurchase-money security interest in a household good held primarily for the personal, family, or household use of the debtor. 11 U.S.C. section 522(f)(2)(A).

Since the Bankruptcy Code does not define a purchase money security interest, the Court must look to Iowa law. In re Butler, No. 86-01651C (Contested No. 1990), slip op. at 4 (Bankr. N.D. Iowa May 28, 1987). The relevant Iowa statute states:

A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

Iowa Code section 554.9107. Since ITT is not a seller as provided in paragraph (a) above, the Court must determine whether ITT's interest in the waterbed is governed by paragraph (b).

III.

The parties do not appear to dispute whether the Waterbed Room store held a purchase money security interest. The Court will assume that it did. The remaining questions to answer are whether the purchase money security interest survived both (1) the assignment by Waterbed Room to ITT and (2) the execution of the Note and Security Agreement by Debtor on June 5, 1986.

These are not questions of first impression in this district. This Court has previously held that a purchase money security continues after an assignment. In re Butler, No. 86-01651C (Contested No. 1990), slip op. at 4 (Bankr. N.D. Iowa May 28, 1987)(citing In re Hobdy, 18 B.R. 70 (Bankr. W.D. Ky. 1982); see Iowa Code ch. 539 and section 554.9318. There is no basis for disturbing this holding here.

Whether ITT's purchase money security interest survived Debtor's refinancing on June 5, 1986 is a more complex question.

The test for determining if it continues is whether a novation of the prior contract has occurred. In re Hansen, No. 86-00638F (Contested No. 671), slip op. at 3 (Bankr. N.D. Iowa March 12, 1987); Averhoff v. Peoples Finance Co. (In re Averhoff), 18 B.R. 198, 202 (Bankr. N.D. Iowa 1982); see also Zweibahmer v. Farmers Home Administration, 25 B.R. 453, 457 n.11 (N.D. Iowa 1982).

In Iowa, a novation is composed of four essential elements: (1) there must be a previous, valid obligation; (2) all parties must agree to the new contract; (3) the new contract must extinguish the old; and (4) the new contract must be valid. Eitzen's Estate v. Lauman, 231 Iowa 1169, ___, 3 N.W.2d 546, 549-50 (1942). Novation is never presumed. Id.

Only the third element--the parties' intent--is in question here. Both parties must clearly intend to extinguish the old, not merely keep the old obligation alive and "accent the new as further security." Id. (citing 39 Am.Jur. 260, par. 14, "Novation"). This intention must be decided from all circumstances. Id. The burden of proving novation is on the party asserting it. Id.

The only evidence presented to the Court were the documents described above. Here, the language of the Security Agreement of June 6, 1986 supplies the necessary indication of the parties' intent. It provides:

If this finances a balance due on a purchase money sales contract or loan, Debtor and Secured Party [ITT] agree (A) that this note renews and does not discharge or extinguish the purchase money contract or loan; (B) that a purchase money security interest is retained to the extent of the balance of the purchase price due; and (C) that each payment received after the date of purchase will reduce the purchase money security interest by the amount applied to principal.

The provision is quite clear. Debtor produced no evidence that the clause is invalid or that it did not state the parties' intent. See Matthews v. Transamerica Financial Services, 724 F.2d 798, 800-01 (9th Cir. 1984). Moreover, novation cannot be presumed. Therefore, the Court concludes that the Note and Security Agreement executed by Debtor did not novate the earlier contract and that the purchase

money security interest created in the contract and assigned to ITT remains. Accordingly, Debtors may not avoid the lien under 11 U.S.C. section 522(f)(2)(A).

ORDER

IT IS HEREBY ORDERED that Debtors Roy Allen Nichols and Tracy Ann Nichols' Motion to Avoid Security Interest and Lien in Exempt Property is denied.

SO ORDERED THIS 29th DAY OF FEBRUARY 1988.

William L. Edmonds
Chief Bankruptcy Judge